BEFORE THE STATE BOARD OF EQUALIZATION

OF THE STATE OF CALIFORNIA

In the Matter of the Appeal of)
)
RUSSELL H. AND TANYA E. RACINE)

Appearances:

For Appellants: Henry W. Howard, Attorney at Law

For Respondent: F. Edward Caine, Senior Counsel

OPINION

This appeal is made pursuant to section 18594 of the Revenue and Taxation Code from the action of the Franchise Tax Board on the protests of Russell H. and Tanya E. Racine to proposed assessments of additional personal income tax in the amounts of $962.33, $1,339.49 and $1,758.93 for the years 1953, 1954 and 1955, respectively.

During the years in question, Russell H. Racine (hereinafter referred to as appellant) and another person, as partners, operated two amusement arcades in the City of Vallejo known as Funcade and Playland. At Funcade and Playland the partners owned and operated from 50 to 60 coin-operated games and amusement devices which included flipper-type pinball games, peep movies, rifle, football and basketball games, juke boxes and at least 15 multiple-odd bingo pinball machines. In addition, beginning in September of 1955, appellant began conducting his own coin machine route in the Vallejo area wherein he owned and placed about five bingo pinball machines and about three miscellaneous amusement machines in four locations. Appellant had one location, the Golden Pheasant, under lease and he received the entire proceeds from the machines located there, In the remaining locations, appellant placed the machines on a 50 percent commission and, accordingly, the gross proceeds of each machine were divided equally between appellant and the location owner, with appellant absorbing most, if not all, of the expenses of operating the machines.

Respondent determined that all of the amounts deposited in the amusement machines constituted gross income to the owner. Respondent also disallowed all expenses arising from the operation of the amusement arcades, except the cost of food, and from appellant's route, pursuant to section 17297 (formerly 17359) of the Revenue and Taxation Code which reads:

> In computing taxable income, no deductions shall be allowed to any taxpayer on any of his gross income derived from illegal activities as defined in Chapters 9, 10 or 10.5 of Title 9 of Part 1 of the Penal Code of California; nor shall

> any deductions be allowed to any taxpayer on any of his gross income derived from any other activities which tend to promote or to further, or are connected or associated with, such illegal activities.

Appellants urge that section 17297 is unconstitutional. Some of the constitutional objections raised by appellants with respect to this section were disposed of in Hetzel v. Franchise Tax Board, 161 Cal. App. 2d 224 (326 P.2d611). In any event, we adhere to our well established policy not to pass upon the constitutionality of a statute in an appeal involving unpaid assessments, since a finding of unconstitutionality could not be reviewed by the courts.- (Appeal of C. B. Hall, Sr., Cal,, St. Bd. of Equal., Dec. 29, 1958, 2 CCH Cal. Tax Cas. Par. 201-197, 3P-H State & Local Tax Serv. Cal. Par. 58145.)

The evidence before us sustains respondent's determination that all of the coins deposited in each machine involved constituted gross income to appellant.

In Appeal of Advance Automatic Sales Co., Cal. St. Bd. of Equal., Oct.9, 1962. CCH Cal. Tax Rep. Par. 201-984, 2 P-H State & Local Tax Serv. Cal. Par. 13288, we held the ownership or possession of a pinball machine to be illegal under Penal Code sections 330b, 330.1 and 330.5 if the machine was predominantly a game of chance or if cash was paid to players for unplayed free games, and we also held bingo pinball machines to be predominantly games of chance,

Respondent's auditor testified that during an interview in 1956 appellant had admitted that it was the general practice at the amusement arcades as well as on appellant's route to pay cash to players of bingo pinball machines for unplayed free games.

A witness who worked at the arcades as a manager and mechanic testified at the hearing of this appeal but, on the grounds of possible self-incrimination, refused to answer questions concerning whether payouts were made to players of pinball machines for free games. Appellant did not appear at the hearing as requested and he later filed a stipulation stating that if he were called as a witness to give testimony in this matter he would decline on constitutional grounds to answer all questions.

A party's refusal to answer a question on the ground of possible self-incrimination can give rise to an inference that a truthful answer to the question would have supported the opposing party's factual contentions. (Fross v. Wotton, 3 Cal. 2d 384 (44 P.2d 350).) Based on appellant's prior admission of payouts and on the inferences to be drawn from appellant's refusal to answer questions relating to the operation of the bingo pinball machines on grounds of possible self-incrimination, we find that it was the general practice to pay cash to players of the bingo pinball machines for unplayed free games, Accordingly, the pinball machine phase of the arcades and the route was illegal, both on the ground of ownership and possession of bingo pinball machines which were predominantly games of chance and on the ground that cash was paid to winning players. Respondent was therefore correct in applying section 17297.

As indicated above, there were from 50 to 60 coin-operated games and

amusement devices at the amusement arcades, including at least 15 bingo pinball machines. The evidence indicates there were also vending machines in the arcades which dispensed cigarettes, candy, coffee and soft drinks, and that there were, in addition, lunch counters from which food, including hot dogs, hamburgers, coffee and milk, were sold. We believe that each arcade portrayed a highly integrated business and we conclude that the various vending machines, amusement machines and lunch counters were highly complementary to one another. We also note that the income from the pinball machines was substantial. There was therefore a substantial connection between the illegal operation of multiple-odd bingo pinball machines and the legal operation of the remainder of the business and respondent was correct in disallowing all expenses of the business with the exception of the cost of food, which is a proper deduction in arriving at gross income. (Cal. Admin. Code, titl. 18, Reg. 17071(c).) We believe that it is also clear that there was a substantial connection between all the machines used on appellant's route and, consequently, respondent correctly disallowed all expenses connected therewith.

There were no records of amounts paid to winning players of the bingo pinball machines for unplayed free games. Respondent estimated these unrecorded amounts as equal to 50 percent of the total amounts deposited in such machines. This estimate was based partly on a statement made to respondent's auditor by appellant when interviewed during 1956 to the effect that payouts for free games averaged about 40 to 50 percent of the total deposited in the bingo pinball machines, both at the arcades and on his route, and partly on the auditor's experience that the average percentage of payouts in the Vallejo area approximated 50 percent. In view of the evidence before us, we conclude that the 50 percent payout estimate is reasonable.

Records relating to the amusement arcades and the route did not indicate a segregation of income between the bingo pinball machines and the other machines, The evidence indicates that there were from 50 to 60 coin-operated games and amusement devices at Funcade and Playland with at least 15 of these units being bingo pinball machines. According to respondent's auditor, appellant estimated that 30 percent of the gross income derived from the games and amusement devices was attributable to the bingo pinball machines. Respondent estimated that 60 percent of the game and amusement machine receipts at the arcades was from the bingo pinball machines, Respondent's auditor testified that he felt that 60 percent was a more realistic figure because he had found that bingo pinball machines produce much more income than other novelty-type equipment.

As we held in Hall, supra, respondent's computation of gross income is presumptively correct. Respondent's segregation of income relative to machines located at the amusement arcades appears reasonable based on our own observations in other cases of this type, and, since appellant has in no way corroborated the estimate he gave to respondent's auditor, respondent's finding must be sustained. However, in the case of appellant's coin machine route we note that respondent has made no attempt at segregating the income between that derived from the bingo pinball machines and that derived from the miscellaneous amusement machines placed out in various locations. Since there was testimony to the effect that about eight machines were placed on location with about five of these being bingo pinball machines, we believe that 80 percent

of the route machine income was attributable to bingo pinball machines.

ORDER

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protests of Russell H. and Tanya E. Racine to proposed assessments of additional personal income tax in the amounts of **$962.33**, $1,339.49 and $1,758.93 for the years 1953, 1954 and 1955, respectively, be modified in that the gross income for 1955 is to be recomputed in accordance with the opinion of the board. In all other respects the action of the Franchise Tax Board is sustained.

Done at Sacramento, California, this 17th day of April, **1963**, by the State Board of Equalization.

Paul R. Leake, Acting Chairman
Richard Nevin, Member
Geo. R. Reilly, Member
Alan Cranston, Member
_____, Member

ATTEST: Dixwell L. Pierce, Secretary